VZCZCXYZ0000
OO RUEHWEB

DE RUEHBU #2598/01 3242139
ZNY CCCCC ZZH
O 202139Z NOV 06
FM AMEMBASSY BUENOS AIRES
TO RUEHC/SECSTATE WASHDC IMMEDIATE 6544
INFO RUEHAC/AMEMBASSY ASUNCION PRIORITY 5752
RUEHBO/AMEMBASSY BOGOTA PRIORITY 1455
RUEHCV/AMEMBASSY CARACAS PRIORITY 1004
RUEHLP/AMEMBASSY LA PAZ NOV 4331
RUEHPE/AMEMBASSY LIMA PRIORITY 1908
RUEHME/AMEMBASSY MEXICO PRIORITY 1247
RUEHOT/AMEMBASSY OTTAWA PRIORITY 0431
RUEHFR/AMEMBASSY PARIS PRIORITY 1161
RUEHQT/AMEMBASSY QUITO PRIORITY 0797
RUEHSG/AMEMBASSY SANTIAGO PRIORITY 5363
RUEHSO/AMCONSUL SAO PAULO PRIORITY 3042
RUEAIIA/CIA WASHINGTON DC PRIORITY
RHMFISS/DEPT OF ENERGY WASHINGTON DC PRIORITY
RUEHC/DEPT OF LABOR WASHINGTON DC PRIORITY
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY
RHMFISS/HQ USSOUTHCOM MIAMI FL PRIORITY
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC PRIORITY
RUCPDOC/USDOC WASHINGTON DC PRIORITY

C O N F I D E N T I A L BUENOS AIRES 002598

SIPDIS

SIPDIS

WHA FOR WHA/BSC AND WHA/EPSC
E FOR THOMAS PIERCE,
PASS NSC FOR JOSE CARDENAS
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
EX-IM BANK FOR MICHELE WILKINS
OPIC FOR GEORGE SCHULTZ AND RUTH ANN NICASTRI
PASS USTR FOR SUE CRONIN AND MARY SULLIVAN
TREASURY FOR ALICE FAIBISHENKO
USDOC FOR ALEXANDER PEACHER AND JOHN ANDERSEN
USCINCSO FOR POLAD

E.O. 12958: DECL: 11/20/2016
TAGS: ECON OECD AR
SUBJECT: ARGENTINA PETROLEUM ROUNDTABLE: U.S. PLAYERS
INVESTING BUT WARY OF REGULATORY AND LABOR ISSUES

REF: BUENOS AIRES 2556

Classified By: ECONCOUNS D.P.CLIMAN. REASONS 1.5 (B,D)

Summary

¶1. (C) Representatives of U.S. upstream and downstream hydrocarbon players Apache, Chevron, Esso, Occidental and Pan-American briefed Ambassador on regulatory, tax and labor issues they face. Key concerns include (1) the immediate impact of an oilfield work stoppage that threatens to disrupt nationwide gas-fired electricity generation; (2) the GoA's mandate that refiners import diesel fuel at a substantial loss; (3) a GoA "invitation" to upstream producers to take proportional equity participations in a new multi-billion dollar refinery project; and (4) looming gas shortages due to delays in the construction of a new Bolivian gas pipeline. They commented that the government is responding to current energy shortages with a very short term perspective, which could easily lead to more problems. U.S. company reps responded cautiously to Planning Minister De Vido's earlier proposal to have the Ambassador host regular meetings of U.S. petroleum players with De Vido to review their problems and concerns. They noted the GoA's penchant for identifying and branding energy sector "troublemakers" and recommended the Ambassador privately represent sector concerns to De Vido.
End Summary

¶2. (SBU) Ambassador met November 16 with representatives of U.S. upstream and downstream hydrocarbon players in the Argentine market to review regulatory, tax and labor issues they face, better understand specific concerns and to develop a consensus advocacy strategy to support these companies' efforts here. Participants included Apache Country Manager Rob Johnston, Chevron San Jorge General Manager Ian Partridge, Esso Country Manager Daniel Risso, Occidental Argentina President Mike Kyle, and Pan American CEO Felipe Bayon.

¶3. (C) Upstream (exploration and development) and downstream (refining) participants reviewed how the GoA,s menu of export tariffs, export restrictions, variable tax concessions, and cascading explicit and implicit price controls have affected their business strategy, profitability and investment decisions. They contrasted current critical concerns -- including oilfield worker stoppages in their Patagonia production fields and recent sudden changes in tax regulations -- with chronic problems that derive from broad micro-economic inefficiencies imposed by the GoA's interventionist managed price regime.

Diesel Shortages, GoA Push for New Refinery

¶4. (C) Esso highlighted the impact of current diesel shortages on downstream refiners: As a result of GoA upstream and downstream regulation and aggressive GoA pressure to control retail prices, gasoline prices at the pump remain approximately 50% below those of neighboring countries. Refinery capacity limitations and supply/demand imbalances have resulted in rolling diesel fuel shortages and GoA demands that refiners import diesel fuel at world market prices to be sold at an approximately $0.20/liter loss on the domestic markets. Esso explained that the GoA effectively demands that refiners cross subsidize diesel imports in order to provide below cost supplies to Argentina's burgeoning and diesel-dependent agricultural sector.

¶5. (C) Largely as a consequence of these politically sensitive diesel shortages, Internal Commerce Secretary Moreno "invited" 25 Argentine upstream producers and downstream refiners in early November to invest in a new 150 million barrel per day (MBD) refinery that will require a total capital investment of $2.25 billion. Under the GoA,s proposal, producers would put up $1.65 billion in fiduciary fund equity, with participation proportionate to current production market share. Private Argentine pension funds would contribute the remaining $600 million. Participants explained that this GoA initiative has been presented to them by the GoA as a "private" project, one in which they would have the right to sell their participations once a secondary market for fiduciary fund shares develops.

¶6. (C) Upstream producers called the GoA's refinery project assumptions unrealistic, particularly its baseline projection of sustained 10% GDP growth for the next 20 years. Key initial concerns producers expressed to the GoA centered on the GoA,s projection of adequate future crude availability to supply the refinery: Crude production in Argentina has been declining steadily since its 1998 peak of 916,000 bb/day to 660,000 bb/day in 2005 as producers failed to bring enough new capacity on line to replacing declining production from mature fields. Chevron estimated that that Argentina would require a major new field discovery every 18 months in order to justify refinery construction. Apache estimated that $3.5 billion of annual new upstream investment would be required to prospect and produce sufficient new crude supplies to allow a new refinery to operate at reasonable capacity.

¶7. (C) Initial upstream producer reaction to the GoA,s proposal was polite. Repsol YPF, Petrobras, Pan American, Chevron and the pension funds volunteered to do engineering and feasibility studies of the GoA,s proposal and return with conclusions and proposals. Participants Chevron, Esso and Pan American made clear they did not think the project

would go forward and, in any case, they were not inclined to consider participation under duress. They noted that Energy Secretary Cameron, quietly told them that such an uneconomic

SIPDIS
project would not go forward while he remained energy secretary. Occidental noted their intent to re-invest its

SIPDIS
Argentina cash flow in new upstream exploration and production activities here rather than in downstream refining projects in which the company has no expertise and no strategic interest.

Gas Shortages and Bolivian Supply Constraints

¶8. (C) Chevron raised the GoA's policy of controlling the wellhead price of natural gas sold domestically has encouraged greater use of existing gas-fired electricity generating capacity at the expense of developing new hydro projects. However, the GoA has yet to provide generators appropriate incentives, promises of secure gas supplies, and power purchase agreement security to promote the development of new gas fired generating capacity. Participants complained that the GoA energy officials have failed to demonstrate either the vision or a commitment to long term planning that will bring new capacity on line fast enough.

¶9. (C) A key concern is whether Bolivia will be able to supply the promised five-fold increase in natural gas supplies cubic meters/day from current import levels averaging 5 million cubic meters. Pan-American joked that Argentina's next big gas basin is Chile -- referring to the GoA's penchant to cut off profitably contacted gas supplies to Chile in order to provide subsidized supplies to domestic markets.

¶10. (SBU) Note: Following a re-negotiation of gas supply prices in June 2006, Argentina currently pays Bolivia in the $5/million BTU range, a 55% increase above prices previously paid. Current Bolivian deliveries to Argentina are in the 5 million cubic meters/day range, with plans to increase imports to an eventual 27 million cubic meters a day following the construction of additional pipeline capacity agreed by Presidents Kirchner and Morales in September. Pipeline project finance has yet to be structured. For its part, Argentina currently supplies Chile in the range of 15 million cubic meters/day of natural gas per day (roughly three times the amount imported from Bolivia) at a price that has risen to the $4.80/MBTU range following an increase in Argentina,s gas export tax this past summer (austral winter) from 20 to 45%. End Note

----
Hydrocarbon Labor Issues: Union Leverage

¶11. (SBU) All hydrocarbon participants complained of lost production due to recent union-directed work slowdowns and a full work stoppage that began November 15. The proximate cause of the work stoppage is a union demand that oil and gas companies agree to gross-up oil and gas workers' salaries to compensate them for high taxes they pay under Argentina's progressive income and asset tax programs. Participants explained that the work slowdowns not only result in major production losses but also in permanent mature field reserve losses. They also noted that a work stoppage of more than a few days would paralyze national gas-fired generating capacity and result in blackouts politically embarrassing to the Kirchner administration.

¶12. (SBU) Note: With the direct intervention of Planning Minster De Vido (at the President's direction), Economy Minister Miceli, Labor Minister Tomada and Energy Secretary Cameron, a settlement was reached with oilfield workers November 17. The resolution involved an agreement by the GoA

to exempt certain oilfield worker transportation and living expense benefits expenses from income tax and an agreement by upstream companies to pay a monthly bonus ranging from $200 - $1000 per worker. However, the settlement has set off additional work stoppages and demands by other unions in the oil sector as well as in other sectors.

Participants Request Low Key Embassy Advocacy

¶13. (C) Ambassador noted Minister De Vido's recent request (Reftel) that the U.S. Embassy continue hosting regular private meetings between the Minister and sector players to review their concerns. Ambassador also suggested the possibility of sponsoring sector specific "best practices" seminars to introduce GoA officials to world class sector regulatory policies. Participants reacted cautiously, noting the GoA's penchant for identifying and branding troublemakers like Shell (for attempting to raise gas pump prices) and Repsol YPF (for insufficient investment in new exploration and development). Instead they recommended that the Ambassador privately represent sector concerns to De Vido, arguing that he would be better received since he represents both existing oil and gas players and potential new investors. They said they would be happy, however, to participate in a sectoral lunch with the Ambassador and De Vido.

Comment

¶14. (C) This first of a series of industry sector-specific briefings for the Ambassador by U.S. company reps was notable for the level of concern they expressed about the increasingly heavy hand of the GoA in energy markets and for their reluctance to directly present these concerns to GoA officials. The fact remains that U.S. upstream players are investing heavily in Argentina: Apache has spent almost a billion dollars purchasing exploration and production facilities (septel), Occidental has announced a USG 1 billion-plus expansion program over the next four years, Pan-American has announced it will spend $600 million a year in exploration, and Chevron is expanding drilling in its current concession areas. The companies admit they remain broadly profitable notwithstanding challenges posed by GoA sector regulation, pricing and tax policies. They emphasize, however, that the GoA's penchant to alter such regulations on short notice and to propose uneconomic schemes like the new refinery project are preventing them from winning home office approval for still more ambitious investment proposals.

¶15. (C) The GoA's agreement to cut oilfield worker income tax payments appears a first step on a slippery slope of accommodation that could well make it harder for the GoA's price control czar, Internal Commerce Secretary Moreno, to control inflationary expectations and prevent a wage/price spiral. Finally, upstream and downstream player reluctance to confront GoA officials on bad energy sector policy -- including a web of export tariffs, export restrictions, variable tax concessions, and cascading explicit and implicit price controls -- is emblematic of an international investor community cowed by GoA bullying and intimidation, in part because they continue to turn a handy profit. This mission will work to increase GoA awareness of the very real costs GoA intervention imposes on the Argentine economy, including the opportunity cost of new investment forgone. We hope this will prove a compelling argument for a Kirchner administration committed to attracting new foreign investment in basic infrastructure development.
WAYNE